Supreme Court, U.S.
FILED

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OFFICE OF THE CLERK

No. ____

In the Supreme Court of the United States

RANDALL WELTY,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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45 pp

QUESTIONS PRESENTED

1. Did the Ninth Circuit Court of Appeals fail to follow the ruling of this Court in United States v. Estate of Romani, 523 U.S. 517, 118 S.Ct. 1478, 140 L.Ed. 2d 710 (1998) by rejecting the Tax Lien Act of 1966 (26 U.S.C. §§ 6321 et seq.) and by applying 31 U.S.C.§ 3713 to a dispute between two creditors, the United States Government and a private citizen, both of whom claim the same interpleader funds?

2. Does 26 U.S.C.§ 6323 control the determination of claim priority when the United States has a judgment under 26 U.S.C. § 6332(d) against a corporation for not honoring a levy to collect taxes owed to the Government by the president of the corporation?

3. May the United States Government avoid the priority allocated by 26 U.S.C. § 6323 (tax liens) by suing and obtaining a judgment against the corporate employer of the taxpayer who owes the tax in order to obtain a priority under 31 U.S.C. § 3713 by virtue of becoming a "judgment creditor"?

4. Which statue, 26 U.S.C. § 6323 or 31 U.S.C. § 3713, applies when the United States Government, owed taxes by an individual, sues the taxpayer's employer for not honoring a levy and obtains a judgment against the corporate employer?

5. May the United States Government, to which taxes are owed by the president of a corporation, avoid the consequences of 26 U.S.C. § 6323, which if applicable, would defeat the Government's priority claim, by suing the corporate employer of the taxpayer/president for failure to

honor a levy imposed by virtue of the failure of the taxpayer/president to pay the tax, and by obtaining a monetary judgment against the corporation, which also was indebted to a competing creditor whose claim would otherwise have had priority under 26 U.S. C. § 6323?

6. Is 31 U.S.C. § 3713, which gives the United States Government priority over all competing claims, constitutional, when the Government acts as a creditor, not as a taxing sovereign? What is the constitutional authority for the Government, not acting to collect taxes, but rather only as a creditor, to declare by statute that its non tax claims have priority over all competing claims? Does such a statute violate the Tenth Amendment, especially where state law favors the earlier lien over the later one?

7. Does 31 U.S.C. § 3713, which gives the United States Government priority over all competing claims, violate the Takings Clause of the Fifth Amendment, when it is used by the Government to extinguish a private citizen's claim (i.e., the private citizen's claim is "taken" without any compensation).

PARTIES TO THE PROCEEDINGS

Petitioner:

Randall Welty

Respondent:

United States of America

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PETITION FOR WRIT OF CERTIORARI

Randall Welty respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered on May 10, 2001.

OPINIONS BELOW

The opinion of the United States Court of Appeals in Law Offices of Jonathan A. Stein v. Cadle Company, 250 F.3d 716, (9th Cir. 2001) is reprinted in Appendix A hereto ("App.A") at page 1a. The opinion was filed on May 10, 2001. The judgment of the United States District Court for the Central District of California, Law Offices of Jonathan A. Stein v. Cadle Company, No. CV 97-5551 SVW was filed on August 25, 1999 is unreported but is reprinted in Appendix B hereto ("App.B") at page 10a. The District Court's Findings of Fact and Conclusions of Law filed June 16, 1999 is reprinted in Appendix C hereto ("App. C") at page 12a.

JURISDICTION

The final judgment of the United States Court of Appeals for the Ninth Circuit affirming the decision of the District Court for the Central District of California was entered on May 10, 2001. This Petition for Writ of Certiorari is filed within 90 days. This Court has jurisdiction by virtue of Title 28, United States Code § 1254(a). See also Rule 13 of this Court's Rules.

CONSTITUTIONAL PROVISIONS INVOLVED IN CASE

Article I, Section 8:

The Congress shall have the power to lay and collect taxes ....

Fifth Amendment:

No person shall be... deprived of... property, without due process of law; nor shall private property be taken for public use, without just compensation.

Tenth Amendment:

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

Sixteenth Amendment:

The Congress shall have the power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.

STATUTORY PROVISIONS INVOLVED

Federal Statutes

Title 26 United States Code, § 6321 provides:

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or accessible penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

Title 26, United States Code, § 6322 provides as follows:

"Unless another date is specifically fixed by law, the lien imposed by § 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed (or judgment against the ray-payer arising out of such liability) is satisfied or becomes unenforceable by reason of lapse of time."

Title 26, United States Code, § 6323 provides, in part, as follows:

"(a) The lien imposed by Section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary.

...

(f) (1) The notice referred to in subsection (a) should be filed -

(A) (ii) In the case of personal property, whether tangible or intangible, in one office within the State (or the county, or other govemmental subdivision), as designated by the laws of such State, in which the property subject to the lien is situated, except that State law merely conforming to or reenacting Federal law establishing a national filing system does not constitute a second office for filing as designated by the laws of such State ...."

Title 31, United States Code, § 3713 provides as follows:

"(a) (1) A claim of the United States Government shall be paid first when (A) A person indebted to the Government is insolvent and – (i) the debtor without enough property to pay off the debt makes a voluntary assignment of property; (ii) property of the debtor, if absent, is attached; or (iii) an act of bankruptcy is committed; or (B) The estate of the deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor. (2) This subsection does not apply to a case under Title 11.

(b) A representative of the person or an estate... paying any part of the debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government."

CALIFORNIA STATUTORY LAW

California Code of Civil Procedure § 697.510 provides as follows:

> "(a) A judgment lien on personal property described in Section 697.530 is created by filing a notice of judgment lien in the office of the Secretary of State pursuant to this article. A judgment lien may be created under this article only if the judgment is a money judgment that was first entered in this state after June 30, 1983. Except as provided in subdivision (b) of Section 697.540, a judgment lien may not be created under this article if the money judgment is payable in installments unless all of the installments under the judgment have become due and payable at the time the notice of judgment lien is filed.
>
> (b) Unless the money judgment is satisfied or the judgment lien is terminated or released, the judgment lien continues for five years from the date of filing.
>
> (c) Notwithstanding Section 697.020, the priority of a judgment lien created under this article does not relate back to the date an earlier judgment lien was created under this article."

STATEMENT OF THE CASE

1. Statement of Facts Set Forth In Ninth Circuit Opinion

The following brief summary of facts is taken directly from the Ninth Circuit's opinion in this case. Following this Statement of Facts from the Ninth Circuit opinion, Petitioner will set forth a more detailed Statement of Facts based upon the Government's brief filed with the Ninth Circuit. The facts are set forth in this manner to give the Government every benefit of the doubt because the issues in this case are strictly legal and constitutional.

"Lyle Byrum incurred a significant tax liability to appellee the United States, and the Internal Revenue Service attempted to levy upon his compensation. Quicksilver refused to honor the levy and continued to pay the compensation to Byrum. The United States sued Quicksilver to enforce the levy and obtained a judgment against it pursuant to the Federal Tax Lien Act.

Quicksilver was involved in litigation against the Riverside County Flood Control and Water Conservation District in the California Superior Court in which it sought to recover for damages arising out of the flooding of its facilities. In June 1996, the United States filed a notice of lien and a copy of its judgment in the Superior Court action.

Randall Welty had sued Quicksilver and obtained a judgment against it in an unrelated matter. In March 1996, he filed that judgment with the California Secretary of State and in September 1996, he filed a notice in the Superior Court action.

The Quicksilver fund was interpled and the action was removed to the federal district court. The court granted summary judgment to the United States on the basis that the federal priority statute gave the government priority over Welty."

2. Government's Version of Facts In More Detail

A. Judgment of the United States against Quicksilver

Quicksilver was a Delaware corporation that sold ultralight and experimental aircraft manufactured in Riverside County, California. Lyle Byrum was the President and Chief Executive Officer of Quicksilver. Byrum owed the Internal Revenue Service a trust fund recovery tax penalty pertaining to a corporation that had previously employed him. In 1989 the IRS served a levy on Quicksilver to collect Byrum's tax liabilities from the salary and other compensation payable to him by Quicksilver. Quicksilver failed to honor the IRS levy served on it, and instead paid Byrum's salary and other compensation directly to Byrum.

The United States then sued Quicksilver in the United States District Court for the Central District of California (Case No. CV 95-6876-GHK (RMCx)) for failing to honor the levy to collect Byrum's tax liabilities from the compensation owed to him by Quicksilver. On January 21, 1996, the district court entered judgment in favor of the United States and against Quicksilver in the amount of $371,130.01, plus accrued interest and other statutory additions as provided by law.

B. The Indian Child case and the filing of judgment liens in the case.

A January 1993 flood had caused extensive property damage to Quicksilver's manufacturing facility in Temecula, California. Quicksilver's liabilities exceeded the value of all its assets after the flood, which therefore rendered Quicksilver insolvent. The company never regained solvency after the flood. In November 1993, Quicksilver and other parties joined in an action, *Indian Child Welfare Consortium, et al. v. Riverside County Flood Control et al.*, Case No. 232232 (Riverside County Superior Court) (the *"Indian Child* case*"*), seeking compensation for the flood damage from the County of Riverside and other defendants.

On June 5, 1996, the United States filed in the *Indian Child* case a notice of lien with a copy of its unpaid $371,130.01 judgment against Quicksilver. After the lien notice was filed, the entire amount of the judgment remained unpaid.

On February 22, 1996 Welty obtained a judgment against Quicksilver in the amount of $533,620 in an unrelated action. On March 28, 1996, Welty filed notice of his judgment with the California Secretary of State. On or about September 30, 1996, Welty filed a notice of lien in the *Indian Child case* with respect to his judgment.

C. Interpleader case

The *Indian Child* case was settled. Quicksilver's former attorney, Jonathan Stein, filed this interpleader case in Los Angeles County Superior Court to determine the priority of competing claimants to settlement proceeds payable to Quicksilver and other *Indian Child* plaintiffs. The United

States removed the action to the United States District Court for the Central District of California.

In is motion for summary judgment, the United States argued that it was entitled to be paid on its judgment against Quicksilver from the interpleader fund because the federal priority statute, 31 U.S.C. § 3713, conferred on the United States priority over the other competing creditors to the fund. The judgment of the United States was entitled to first priority, the United States argued, because, as required under the federal priority statute, Quicksilver was insolvent and committed acts of bankruptcy, including failing to discharge the judgment lien of the United States within thirty days. Although the United States also had separate federal tax liens against Quicksilver, those liens were not a basis for the summary judgment motion of the United States.

In opposing the summary judgment motion, Welty argued that the priority of the judgments of the United States and Welty should be determined, not by the federal priority statute, but by the statute applicable to determining the priority of federal tax liens, section 6323 of the Internal Revenue Code (26 U.S.C.) (the "Code" or "I.R.C."), which Welty refers to generally as the "Federal Tax Lien Act of 1996." Welty further argued that even if the federal priority statute applied, the requirements of this statute were not fulfilled. Welty therefore claimed that he was entitled to the interpleader fund because his judgment lien was allegedly prior to the judgment lien of the United States under I.R.C. § 6323.

D. The district court decision

On April 7, 1999, the district court issued its "Order Denying United States' Motion for Summary Judgment and

Setting Evidentiary Hearing." In the Order, the court first noted that the federal priority statute provides for the first priority of a claim of the federal government "if an entity (1) is insolvent and (2)... commits an 'act of bankruptcy.'" The court therefore held that if Quicksilver was insolvent and committed an act of bankruptcy, the claim of the United States must be paid first.

On the issue of Quicksilver's insolvency, the court determined that it was necessary to conduct an evidentiary hearing. The court did indicate, however, that Quicksilver's failure to discharge the judgment lien of the United States within thirty days after the lien was obtained was an act of bankruptcy as argued by the United States.

The district court rejected the argument made by Welty and the other claimants that I.R.C. § 6323, and not the federal priority statute, determined the priority of the judgment of the United States. The court held that section 6323 only applied to determine the priority of a federal tax lien. In this case, the court explained, the claim of the United States was not based on a federal tax lien against Quicksilver. It was based on a judgment for Quicksilver's failure to honor a levy, and such a claim did not give rise to a federal tax lien. Accordingly, the court held that the federal priority statute applied to this case.

The district court also rejected the competing claimants' argument that an exception to the federal priority statute for lienholders who have gained possession or title to the debtor's property applied in this case. Not only could the claimants not demonstrate "an actual possession of the property," the court held, but "[i]n fact, only Claimant Welty filed a notice of lien in the *Indian Child* action itself, and Welty did so after the United States filed its own notice of

lien." Accordingly, the court ruled that such an exception was inapplicable in this case.

After the evidentiary hearing on the issue of Quicksilver's insolvency, the district court, on June 16, 1999, issued its "Findings of Fact and Conclusions of Law." The court held that Quicksilver was insolvent from June 5, 1996, the date on which the United States filed its notice of its judgment lien in the *Indian Child case,* until July 6, 1996, the close of the thirty-day period following the filing of the lien. The court therefore held that Quicksilver was insolvent at the time it committed its act of bankruptcy, which the court had previously held to be the failure to dis-charge the judgment lien of the United States within thirty days of the filing of the notice of lien. The court concluded that the claim of the United States was therefore entitled to be paid first.

On August 25, 1999, the district court granted the motion for summary judgment of the United States and ordered entry of judgment in favor of the United States and against all other parties for the entire remaining amount of the interpleader fund, which, after being partially distributed to other parties pursuant to settlements reached earlier in the case, was less than the amount of the unpaid judgment of the United States. On August 26, 1999, the district court Clerk entered the judgment. Welty appealed.

REASONS FOR GRANTING THE WRIT

A. This Court Should Decide Whether The Ninth Circuit Misapplied United States v. Estate of Romani, 523 U.S. 517 (1998) In Refusing to Apply The Tax Lien Statute (26 U.S.C. §6323)

In 1998 this Court in United States v. Estate of Romani, 523 U.S. 517, 118 S.Ct. 1478, 148 L.Ed.2d 710 (1998)rejected the Government's attempt to use the federal insolvency statute to create unrecorded or secret tax liens. This Court held that the United States Government was required to comply with the notice requirement of the Federal Tax Lien Act of 1966 (26 U.S.C. § 6323). This Court reasoned as follows:

> "There are sound reasons for treating the Tax Lien Act of 1966 as the governing statute when the Government is claiming a preference in the insolvent estate of the delinquent taxpayer. As was the case with the National Bank Act, the Transportation Act of 1920, and the Bankruptcy Act of 1898, the Tax Lien Act is the latter statute, the more specific statute, and its provisions are comprehensive, reflecting an obvious attempt to accommodate the strong policy objections to enforcement of secret liens. It represents Congress's detailed judgment as to when the Government's claims for unpaid taxes will yield to many different sorts of interests (including, for instance, judgment liens, mechanic's liens, and attorney's liens) in many different types of property (including, for example real property,

securities, and motor vehicles). See 26 U.S.C. § 6323 ...."

See United States v. Estate of Romani, 522 U.S. at 532.

This Court also stated in United States v. Estate of Romani, supra,

> "... [G]iven our unambiguous determination that the federal interest in collection of taxes is paramount to its interest in enforcing other claims, see United States v. Kimbell Foods, Inc, 440 U.S. at 773-735, 99 S.Ct., at 1461-1462, it would be anomalous to conclude that Congress intended the priority statute to impose greater burdens on the citizen than those specifically crafted for tax collection purposes."

It is clear that this case involves a collection effort by the United States Government. The error of the Ninth Circuit in essentially rejecting the holding of this Court's decision in United States v. Estate of Romani is that the Ninth Circuit incorrectly concluded that the Federal Tax Lien Act of 1966 had no application because the liability of the Government is asserting in this case is not for taxes but rather is instead simply a judgment upon an employer for failing to honor a wage levy. The Ninth Circuit, as well as the District Court below, ignored the fact that this case is essentially a tax collection case. The Government's judgment against the employer of the delinquent taxpayer was for the purpose of collecting the tax against the corporation's president. The purpose of the proceeding which led to the judgment against

the corporation was to enforce a tax lien against an employee of the corporation [its president].

The District Court and the Ninth Circuit erred. Apparently the District Court and the Ninth Circuit would have been satisfied had the Government brought an action directly against the primary debtor, Lyle Byrum, the president of the company against whom the judgment was eventually rendered. The corporation was only secondarily liable for Mr. Byrum's taxes. Yet the Government got a better deal than it would have gotten had it proceeded directly against Mr. Byrum. This creates an anomaly wherein the right of the Government is greater against the secondarily liable party than against the primary party, the taxpayer. Everyone agrees that had the proceeding been brought directly against the taxpayer the Government would have failed because Petitioner Welty had a prior claim. The Government should not be able to circumvent the priority statute by the end run in this particular case. The tax collection process would become more convoluted if the Government were going against a party for being a transferee of the assets of the taxpayer. In that situation the Government would be bound to follow the requirements of the 1966 Federal Tax Lien Act. This conclusion follows from the fact that 26 U.S.§ 6901 provides that transferee liability may be "... assessed, paid, and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred ...."

Thus, depending upon the particular procedural method of tax collecting being used by the Government to secure payment of an employee's taxes, the Government may bounce back and forth as to the use or not use of the Federal Tax Lien Act of 1966, as compared to the Federal Insolvency Act. Such a result hardly seems to "bespeak a strong

condemnation of secret liens, which unfairly defeat the expectations of innocent creditors and frustrate 'the needs of our citizens for certainty and convenience and the legal rules governing their commercial dealings ....'" United States v. Romani, 523 U.S. at 533, 118 S.Ct. at 1488.

This Court in the Romani case stated that the later, more specific statute should govern over the older, more general statute. The whole idea of the tax lien statute was to eliminate secrete liens and to provide more protection and fairness to taxpayers. The Government should have recorded its lien rights to establish its priority, not ignore the federal tax lien statute altogether and rely, instead, upon a much older, general statute.

This Court should grant the Writ of Certiorari to explore this issue in more depth and to explain whether United States v. Estate of Romani, just decided by this Court three years ago, can be cavalierly disregarded by circuit courts.

B. This Court Should Decide Whether 26 U.S.C.§ 6323Is Constitutional In Light of Alden v. Maine, __ U.S. __, 119 S.Ct. 2240 (1999)

The District Court and the Ninth Circuit refused to apply 26 U.S.C. § 6323, which, had it applied, would have resulted in a favorable judgment for Mr. Welty, a citizen of the State of California.

While it is true that there are previous cases by this Court applying federal priority statutes regarding judgments and claims, as for example, Brandwell v. United States Fidelity & Guarantee Co., 269 U.S. 483, 46 S.Ct. 176

(1926), the priority statute can no longer be constitutional in light of Alden v. Maine, __U.S.__, 119 S.Ct. 2240 (1999), which recognizes and acknowledges state sovereignty.

This Court stated in Alden v. Maine, supra,

> "We hold that the powers delegated to Congress under Article I of the United States Constitution do not include the powers to subject non consenting states to private suits for damages in state courts."

This Court continued in Alden v. Maine to point out how important state soverignty is and emphasized the limited nature of the federal government over the states and over the people. This Court stated that the powers granted to the federal government are limited and enumerated powers. This Court stated,

> "The federal system established by our Constitution preserves the sovereign status of the States in two ways. First, it reserves to them a substantial portion of the Nation's primary sovereignty, together with the dignity and essential attributes inherent in that status
> ....
> Second, even as to matters within the competence of the National Government, the constitutional design secures the founding generation's rejection of 'the concept of a central government that would act upon and through the States' in favor of 'a system in which the State and Federal Governments would exercise concurrent authority over the people - who were, in Hamilton's words 'the

only proper objects of government.'" *id* at 2247s

In this context the State of California has created certain statutes designed to regulate the priority of claims. *See,* e.g., California Code of Civil Procedure §697.510. If one follows the California statutory scheme one is to benefit by a priority that the state scheme provides.

It is essentially the function of the State to establish the !aw creating and recognizing property rights.

Here, the Federal Priority Statute, 31 U.S.C. § 3713, cannot be justified on the basis of any national sovereignty. Arguably the United States Government could establish a priority under its constitutional authority to levy taxes. *See, e.g.*, Article I, Section 8 and the Sixteenth Amendment to the United States Constitution. Every government has an inherent right to exist. To the extent the United States' Government has the right to impose taxes arguably it may enact statutes to give it priority with respect to the collection of taxes. Indeed the Government does have a general priority right to collect taxes. Congress, however, has imposed some limits on the ability of the federal government to enforce the tax laws. The United States Congress was not constitutionally required to adopt 26 U.S.C. § 6321 and its related sections. Petitioner concedes that the Government might have adopted a statute more sweeping in scope and more protective of the Federal Government's right to collect taxes. Such a statutory scheme would be supported by specific references in the Constitution to the right of the Federal Government to collect taxes.

However, in contrast to the taxing right of the Federal Government, there is no similar right for the Federal Government to give itself priority over state creditors by

unilaterally declaring its priority. As between a judgment creditor who happens to be a State citizen on the one hand and the Federal Government on the other, also a creditor, the Federal Government should not be able to establish itself as the one with the priority. What provision in the United States Constitution gives the Federal Government the right to put itself first in line when it is acting only as a general creditor, and not as a tax collector?

This Honorable Court is respectfully requested to keep in mind that Petitioner does not contend that the United States Government cannot give itself priority when collecting taxes. In this case, however, if we take the Government at its word, that it was simply collecting a judgment and not collecting a tax, then there is no reason to put the Government first. Again, Petitioner asks: What specific provision of the United States Constitution gives the United States Government the right to declare that it has priority over competing claims by state citizens?

Petitioner respectfully submits that in light of Alden v. Maine, which expressly recognized the limited nature of the Federal Government 31 U.S.C. §3713 cannot be constitutional.

The Government has taken essentially inconsistent positions with respect to this case and the application of federal statutes. If this were a tax case Petitioner concedes the Government should prevail. Since the Government has expressly disavowed the tax statute and has, instead, relied upon the priority statute, it must lose. The Government cannot take inconsistent positions. The federal priority statute, 31 U.S.C.§ 3713, may not constitutionally be applied to give the Government priority over a competing claim by a state citizen. There is no authority in the Constitution for Congress

to adopt such a statute and it does fly in the face of the Tenth Amendment to the United States Constitution, which gives soverignty to the states and to the people.

Accordingly, this Court should grant certiorari to deal with this most important issue involving federal priority of claims. The United States Government essentially argues that it can give itself priority simply by declaring such priority in a federal statute. Again, a government should have authority to preserve its own status. Governments do need money. However, governments get their money by taxes, not by suing and obtaining judgments. If the Government should have the right to sue to collect a judgment against a debtor, it should not have any greater rights than a private citizen of the particular state who also has a claim against the same debtor.

Nothing in the United States Constitution gives the Federal Government the right to declare itself the winner when there are competing claims by two judgment creditors for the same funds. As between the United States Government on the one hand and a state citizen on the other, if each one has a claim against a particular debtor, if the claim is non tax related, the Government should not automatically win simply by declaring itself the winner.

Petitioner cannot repeat enough that this is not a tax case according to the Government and according to the Ninth Circuit. If it were Petitioner would concede the right of the Government to collect its taxes. This is not such a case according to the Government.

Certiorari should be granted so that this Court can give more consideration to this important issue of federal priority in light of Alden v. Maine and other recent similar cases recognizing the limited authority of the Federal Government.

CONCLUSION

For the foregoing reasons, Petitioner respectfully urges this Court to grant the Writ of Certiorari.

Respectfully submitted,

ROGER JON DIAMOND
Attorney for Petitioner

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

[April 17, 2001, Argued and Submitted, Pasadena, California]
[May 10, 2001, Filed]

No. 99-56751

LAW OFFICES OF JONATHAN A. STEIN,
Plaintiff,

v.

CADLE COMPANY; BRUCE WILBANKS; FUERTE CORPORATION, dba Quicksilver Aircraft; RONALD J. MANDELL,
Defendants,

and

UNITED STATES OF AMERICA,
Defendant-Appellee,

v.

RANDALL WELTY
Defendant-Appellant.

Appeal from the United States District Court for the Central District of California
Stephen V. Wilson, District Judge, Presiding

Before: Harry Pregerson, Ferdinand F. Fernandez, and Susan P. Graber, Circuit Judges. Opinion by Judge Fernandez.

OPINIONBY:Ferdinand F. Fernandez

SUMMARY

Government Law/Tax

The court of appeals affirmed a judgment of the district court. The court held that the Federal Tax Lien Act does not control the determination of claim priority when the government has a judgment under the Act against a person who failed or refused to honor a compensation levy.

Lyle Byrum incurred a significant tax liability to appellee the United States, and the Internal Revenue Service attempted to levy upon his compensation. Quicksilver refused to honor the levy and continued to pay the compensation to Byrum. The United States sued Quicksilver to enforce the levy and obtained a judgment against it pursuant to the Federal Tax Lien Act.

Quicksilver was involved in litigation against the Riverside County Flood Control and Water Conservation District in the California Superior Court in which it sought to recover for damages arising out of the flooding of its facilities. In June, 1996, the United States filed a notice of lien and a copy of its judgment in the Superior Court action.

Randall Welty had sued Quicksilver and obtained a judgment against it in an unrelated matter. In March 1996, he filed that judgment with the California Secretary of State and in September 1996, he filed a notice in the Superior Court action.

The Quicksilver fund was interpled and the action was removed to he federal district court. The court granted summary judgment to the United States on the basis that the federal priority statute gave the government priority over Welty.

Welty appealed.

[1] Under the federal priority statute, a claim of the United States Government must be paid first when a person indebted to the Government is insolvent and an act of bankruptcy is committed. Under the Federal Tax Lien Act, a lien is not valid as against any purchaser or judgment lien creditor until notice thereof which meets the requirements has been filed by the Secretary.

[2] The Tax Lien Act refers to the taxpayer in its declaration that if any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United State upon all property belonging to such person. If the tax is not paid, the lien provided springs into being. Notice of that "secret lien" against the taxpayer's assets must be given. This case did not deal with that kind of secret lien.

[3] An action under the Tax Lien Act is not a suit for the collection of a tax; it is a suit to enforce personal liability for failure to surrender property belonging to a delinquent taxpayer. [4] Quicksilver did not become a taxpayer, or a

person who owed taxes, when it failed to turn over Byrum's property to the government. It simply became liable for the separate wrongdoing of the failure to honor a levy. In this context, Quicksilver was not a taxpayer, and the Tax Lien Act did not apply.

OPINION

The district court determined that the Federal Priority Statute, 31 U.S.C. § 3713,[1] gave the United States the right to be paid first from a fund of its judgment debtor, Quicksilver Enterprises, Inc. That determination resulted in precluding Randall Welty, who was also a judgment creditor of Quicksilver, from receiving any amount whatsoever from the fund. He appeals and asserts that the Federal Tax Lien Act, 26 U.S.C. § 6323,[2] should have been applied instead. We affirm.

BACKGROUND

Lyle Byrum was the President and Chief Executive Officer of Quicksilver, which had been engaged in the manufacture of ultralight and experimental aircraft before it became insolvent. He had previously incurred a significant tax liability to the United States, and the Internal Revenue Service attempted to levy upon his compensation. Quicksilver refused to honor the levy and continued to pay the compensation to Byrum. The United States then sued Quicksilver to enforce

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[1] Hereafter, when we refer to § 3713, it is to this provision.

[2] Hereafter, when we refer to § 6323, it is to this provision.

the levy and on January 31, 1996, obtained a judgment of $ 371,130.01 against it pursuant to 26 U.S.C. § 6332(d).

As it happened, Quicksilver was then involved in litigation against the Riverside County Flood Control and Water Conservation District in the Superior Court of the State of California for the County of Riverside, in which it sought to recover for damages arising out of the flooding of its facilities. On June 5, 1996, the United States filed a notice of lien and a copy of its judgment in the Superior Court action, as [**3] is provided by California law. See Cal. Civ. Proc. Code §708.410. In the meantime, Welty had sued Quicksilver and obtained a $ 533,620 judgment against it in an unrelated matter. On March 28, 1996, he filed that judgment with the California Secretary of State. See Cal. Com. Code § 9401. On September 30, 1996, he also filed a notice in the Superior Court action.[3] The Quicksilver fund was then interpled, and in due course the district court granted summary judgment to the United States on the basis that § 3713 gave the government priority over Welty. This appeal followed.

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[3] The government now argues that Welty did not perfect his claim when he filed his notice with the Secretary of State. There could be something to that argument. See *Bluxome St. Assocs. v. Fireman's Fund Ins. Co.*, 206 Cal. App. 3d 1149, 1156, 254 Cal. Rptr. 198, 202 (1988). However, the government made no such argument to the district court, and we decline to allow it to raise the issue for the first time on appeal. See *Crawford v. Lungren*, 96 F.3d 380, 389 n.6 (9th Cir. 1996); *Broad v. Sealaska Corp.*, 85 F.3d 422, 430 (9th Cir. 1996); *O'Rourke v. Seaboard Sur. Co. (In re E.R. Fegert, Inc.)*, 887 F.2d 955, 957 (9th Cir. 1989).

JURISDICTION AND STANDARD OF REVIEW

The district court had jurisdiction over this removed action pursuant to 28 U.S.C. § § 1331, 1335, and 1441. We have jurisdiction pursuant to 28 U.S.C. § 1291. We review de novo the district court's grant of summary judgment to the United States. See *Lopez v. Smith*, 203 F.3d 1122, 1131 (9th Cir. 2000) (en banc); *Berry v. Valence Tech., Inc.*, 175 F.3d 699, 703 (9th Cir. 1999).

DISCUSSION

As the facts show, this is a winner-takes-all case. If the United States has priority, its judgment will absorb the whole fund. If Welty has priority, his judgment will do so. Welty relies upon his March 23, 1996, filing with the California Secretary of State to obtain priority; the United States relies upon § 3713. The government does note that it obtained its judgment on January 31, 1996, and filed its notice in the Superior Court action on June 5, 1996. But Welty does not seek to rest his case on the assertion that he would have priority if § 3713 applies; he simply argues that it does not apply because § 6323 applies instead. It is to that narrow issue that we will direct our attention.

Let us start by setting forth the provisions of those statutes. In pertinent part, the former declares, in exceedingly broad terms, that "[a] claim of the United States Government shall be paid first when ... a person indebted to the Government is insolvent and ... an act of bankruptcy is committed." 31 U.S.C. § 3713(a)(1)(A)(iii). In pertinent part, the latter narrowly declares that "the lien imposed by section 6321 shall not be valid as against any purchaser ... or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the

Secretary." 26 U.S.C. § 6323(a). Welty does not dispute the district court's determination that Quicksilver was insolvent and had committed an act of bankruptcy. Thus, he essentially concedes that § 3713 applies unless its sweep is limited by § 6323. Is it?

The Supreme Court has partially answered that question. See *United States v. Estate of Romani,* 523 U.S. 517, 118 S. Ct. 1478, 140 L. Ed. 2d 710 (1998). In Romani, the government sought to obtain priority over other creditors of a tax-payer by using § 3713 in a situation where it had not complied with § 6323. *Id.* at 519, 118 S. Ct. at 1480-81. The Court rejected that attempt. It pointed out the fact that § 6323 had been enacted long after the predecessor to § 3713 --over 150 years later. It then said that "a specific policy embodied in a later federal statute should control our construction of the priority statute [§ 3713], even though it has not been expressly amended." *Id.* at 530-31, 118 S. Ct. at 1486. And, it declared, "there are sound reasons for treating the Tax Lien Act of 1966 as the governing statute when the Government is claiming a preference in the insolvent estate of a delinquent taxpayer." *Id.* at 532, 118 S. Ct. at 1487. The Court matched its action to that thought and held that "nothing in the text or the long history of interpreting the federal priority statute justifies the conclusion that it authorizes the equivalent of a secret lien as a substitute for the expressly authorized tax lien that Congress has said 'shall not be valid' in a case of this kind." *Id.* at 534, 118 S. Ct. at 1488.

Therefore, Welty would certainly be correct, if the government's judgment were covered by § 6323. Unfortunately for his position, it is not. Section 6323 speaks only to the truly secret lien imposed by 26 U.S.C. § 6321. The latter section refers to the taxpayer in its declaration that

"if any person liable to pay any tax neglects or refuses to pay the same after demand, the amount ... shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." Any doubt that § 6321 refers to the taxpayer when it speaks of a "person liable to pay any tax" is dispelled by the context in which it is nestled. The IRS is given the authority to assess taxes, and must do that in a particular manner. See 26 U.S.C. §§ 6201-6204. Thereafter, it must give notice to the taxpayer and demand payment. *See id.* § 6303. If the tax is not paid, the lien provided for in 26 U.S.C. § 6321 springs into being. Under §6323, notice of that "secret lien" against the taxpayer's assets must be given. In fact, Romani involved just that sort of situation. The Court was dealing with a 26 U.S.C. § 6321 lien that covered the property of the taxpayer himself or, rather, the property of his estate. See *Romani,* 523 U.S. at 519-20, 118 S. Ct. at 1481. But the case at hand does not deal with that kind of secret lien at all.

This case involves a judgment against a company, Quicksilver, on account of its failure to surrender property subject to levy. See 26 U.S.C. § 6332(d)(1). Quicksilver did not fail to pay a tax; it failed to honor a levy. It did not become liable for a tax; it became liable for the value of the property it failed to turn over. Id. As the Sixth Circuit has pointed out, § 6332(d) is designed "to enforce the personal liability of [a person] for failure to honor the notice of levy." *United States v. Weintraub,* 613 F.2d 612, 616 (6th Cir. 1979); see also *id.* at 620. To put it another way, an action under that section is not "a suit for the collection of a tax. It is a suit to enforce personal liability for failure to surrender property belonging to a delinquent taxpayer." *Commonwealth Bank v. United States,* 115 F.2d 327, 330-31 (6th Cir. 1940); see also *Weintraub,* 613 F.2d at 616 n.9.

That distinction is fatal to Welty's position. When Quicksilver failed to honor the levy, liability followed, but not because it was responsible for the underlying taxes. Quicksilver did not become a taxpayer, or a person who owed taxes, when it failed to turn over Byrum's property to the government. Quicksilver's situation is no different from the usual plight of a person who does not honor a levy. If, for example, one refuses to honor a levy of execution on a tort judgment against a person who injured another in an accident, one does not become a person who owes damages for an inflicted injury. One simply becomes liable for the separate wrongdoing of failure to honor a levy. See, e.g., Cal. Civ. Proc. Code § 701.020 ("If a third person is required by this article to deliver property to the levying officer or to make payments to the levying officer and the third person fails or refuses without good cause to do so, the third person is liable to the judgment creditor ...."). That is what has happened to Quicksilver. In short, in this context Quicksilver is not a taxpayer, and the provisions of § 6323 do not apply.

CONCLUSION

We do not undertake to explore all the arcane issues lurking in the hoary recesses of 31 U.S.C. § 3713. Rather, we answer only one question: Does 26 U.S.C. § 6323 control the determination of claim priority when the government has a judgment under 26 U.S.C. § 6332(d) against a person who failed or refused to honor a levy? We hold that it does not. Therefore, the district court correctly determined that the United States had § 3713 priority.

AFFIRMED.

APPENDIX B

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

[August 25, 1999, Filed]

No. CV 97-5551 SVW

LAW OFFICES OF JONATHAN A. STEIN, Plaintiff,	)
v.	)
CADLE Co., et al. Defendants.	)

JUDGMENT

The Court has granted Defendant United States' motion for summary judgment. Accordingly, the Court ORDERS that JUDGMENT be entered in favor of Defendant United States and against all other parties for the amount of the entire interpled fund in this case ($398,904.00 deposited on December 1, 1997) plus interest minus any disbursements as ordered by the Court before this date.

IT IS SO ORDERED:

/s/_____
STEPHEN V. WILSON
UNITED STATES DISTRICT
JUDGE

APPENDIX C

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

[June 16, 1999]

No. CV 97-5551 SVW

LAW OFFICES OF JONATHAN A. STEIN, Plaintiff,	)
v.	)
CADLE Co., et al. Defendants.	)

FINDINGS OF FACT

I. Introduction

This case began when Plaintiff filed his complaint in interpleader in Los Angeles Superior Court on June 26, 1997. The United States removed the action to this Court. The complaint seeks a declaration of the rights of the various claimants to the interpled funds, which stem from the May

1997 settlement in the Indian Child case.[1] While Plaintiff actually divided the fund into two parts, for present purposes, Plaintiff received all of the funds, slightly over $300,000, based on the claims of a corporation named Quicksilver in the Indian Child case.

The remaining claimants to the interpled fund consists of creditors of Quicksilver.[2] These claimants include Cadle Company, Quicksilver Manufacturing, INc. ("QMI"), Har-Bro, Inc., Bruce Wilbanks, the United States, and Randall Welty.[3] Most of these claimants are creditors of Quicksilver; some claim to have lien interests in the proceeds from the Indian Child case. The United States and Randall Welty claim an interest in the fund from the Indian Child case through their judgment lien notices filed in that case.

Briefly, the United States argues that it obtained a judgment against Quicksilver from a Court in this District in the amount of slightly over $970,000 - the payment of which would exhaust the interpled fund. That judgment arose from Quicksilver's failure to pay a levy against the salary of its

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[1] Indian Child Welfare Consortium v. Riverside County Flood Control and Water Conservation Dist., Case No. 242232, Riverside County Superior Court.

[2] Plaintiff and Fuerte Corporation claimed that Fuerte obtained an assignment of Quicksilver's chose in action in the Indian Child case through a foreclosure. The California Court of Appeals rejected that contention. Accordingly, Plaintiff and Fuerte do not maintain claims against the fund.

[3] The State of California, while mentioned in the complaint, never answered and did not participate in the summary judgment motion or the evidentiary hearing.

President, Lyle Byrum's, after Byrum's failure to pay taxes. The United States moved for summary judgment based on its asserted priority under federal law against the claims of the other creditors.[4]

On April 7, 1999, the Court denied the motion for summary judgment. In that Order, the Court found that the Federal Insolvency Statute applied to this case and that Quicksilver committed an act of bankruptcy for purposes of that statute. The Court noted that it could not grant summary judgment for the United States because that would also require the Court to determine that Quicksilver committed the act of bankruptcy during insolvency. The Court found that a factual dispute existed on that question. Accordingly, the Court scheduled an evidentiary hearing for April 27, 1999 to consider the question of insolvency. Specifically, the Court needed to determine whether Quicksilver's liabilities exceeded its assets for the thirty day period after its "act of bankruptcy" on August 5, 1996. The Court conducted a further hearing in the matter on May 11, 1999. Based on the evidence adduced at that hearing and in accord with Fed. R. Civ. P. 52(a), the Court now enters its findings of fact and conclusions of law.

II. Findings of Fact

Lyle Byrum, formerly CEO, CFO, and director of Quicksilver, testified credibly and extensively regarding Quicksilver's insolvency. The Court finds Byrum's testimony credible despite the fact that if Quicksilver pays the government it will discharge some of Byrum's tax liability.

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[4] The United States also claims to have some tax liens against Quicksilver but reserved those claims pending the resolution of this claim.

Byrum explained that Cinema Exec foreclosed on Quicksilver's assets in late 1995. By June of 1996, Quicksilver had no assets, except for its interest in the Indian Child case, and its liabilities amounted to more than two million dollars.

Government exhibits 201 and 202 support Mr. Byrum's testimony. Those exhibits demonstrate that in May of 1994 and May of 1995, Quicksilver had liabilities in excess of its assets. Mr. Warren Christensen, an accountant hired by Quicksilver to prepare financial statements for the company, testified in a deposition that his firm had prepared government exhibits 201 and 202.

The other claimants contended that these financial statements do not provide the complete picture of Quicksilver's assets in 1994 and 1995. They argued that the financial statements did not reflect money spent on research and development, the value of a manufacturing certificate, and an order for a large number of planes. The claimants also questioned the nature of the financial statements: they noted that the statements used the accrual method and recorded items on a cost, rather than fair market value, basis. The Court does not find that any of these arguments demonstrate that Quicksilver was solvent in June and July of 1996.

First, Mr. Byrum demonstrated that the financial statements did accurately reflect the financial condition of the company, including the order for planes. Second, the claimants offer no evidence that Quicksilver would have been solvent in 1996. That is, even if the financial statement did not account for certain items in May of 1995, the claimants do not demonstrate the value of those items or compare that value to the significant liabilities. Third, the claimants' arguments miss the point. Even if Quicksilver did have

greater assets than the financial statements reflect, due to the failure to account for fair market value, Quicksilver transferred all of its assets, except its interest in the Indian Child action, to Cinema Exec in late 1995. Accordingly, the Court finds that Quicksilver was insolvent from June 5 to July 5, 1996.

III. CONCLUSIONS OF LAW

Based on the reasoning in the Court's April 7, 1999, Order, the Court finds that the Federal Insolvency Statute applies and that Quicksilver committed an act of bankruptcy during insolvency. Accordingly, the "claim of the United States Government shall be paid first." 31 U.S.C. § 3713(a)(1).[5]

The only remaining issue concerns the fee award, if any, to Plaintiff Stein. The United States has previously suggested that Mr. Stein deserves no fees; Stein disagrees. The Court noted in the April 7 Order that it would invite further briefing on this issue after the resolution of the claims of the other creditors. See Order at 10 n. 14. Plaintiff Stein should file a brief requesting fees in this matter by June 28, 1999. The government should respond by July 6, 1999. Stein may file a reply, if he desires, by July 12, 1999. The Court will hear the matter on July 19, 1999 at 1:30 p.m.

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[5] As the Court noted in the April 7 Order, the government's priority defeats claimant QMI's claim as well. See Order at 9-10 n. 13. QMI cannot demonstrate that it obtained "title or possession" of the assets at issue.

IT IS SO ORDERED:

/s/_____
STEPHEN V. WILSON
UNITED STATES DISTRICT
JUDGE